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PERSPECTIVE

SEC's whistleblower program is gaining steam

By Marc J. Fagel

Since its creation earlier this decade as part of the Dodd-Frank Act's overhaul of the federal securities laws, the Securities and Exchange Commission's whistleblower program has been gradually growing in scope and significance. The first half of 2016 provided not just multiple examples of tipsters reaping large rewards, but pointed illustrations of the pitfalls a company may encounter if it fails to appreciate the sensitivities around whistleblower complaints.

Under Dodd-Frank and the SEC's subsequent rulemaking, whistleblowers who provide original information which results in the SEC's successful pursuit of an enforcement action may be awarded 10-30 percent of any monetary recovery (in excess of $1 million) obtained by the agency. According to the SEC's 2015 annual whistleblower report, the agency received over 4,000 tips — up 8 percent from fiscal year 2014 and 30 percent from the program's first full year in 2012. (Notably, California continues to be the state generating the largest number of whistleblower tips.) The SEC paid more than $37 million to whistleblowers in 2015.

Since the release of that report, there has been a spate of additional awards, including:

• On Jan. 15, the SEC announced an award of more than $700,000 to a company outsider whose analysis led to a successful enforcement action. The SEC's press release touted its interest in receiving detailed information from industry experts.

• On March 8, the SEC announced an award totaling almost $2 million — $1.8 million to the original whistleblower and approximately $65,000 each to two other whistleblowers who subsequently offered additional information.

• On May 13, the SEC authorized an even larger award, $3.5 million, to a company employee whose tip strengthened an ongoing investigation with additional evidence. The agency pointed to this as encouragement for all to come forward even if the SEC may already be looking into the wrongdoing they have observed.

• On May 17, the SEC announced an award of between $5 and $6 million to a whistleblower whose "detailed tip" uncovered violations that ostensibly would have been impossible for the agency to detect but for the whistleblower coming forward.

• And finally, on June 9, the SEC announced its second highest award to date, paying $17 million to a company insider for detailed information advancing the agency's investigation.

The growing number and magnitude of these awards will undoubtedly serve to motivate an expanding number of potential whistleblowers to come forward. At the same time, the SEC took several opportunities in recent months to call out companies which had failed to treat internal whistleblower claims with adequate seriousness or, in the eyes of the SEC, had dissuaded potential whistleblowers from approaching the government.

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For example, in a March 2016 financial fraud case, *In re ModusLink Global Solutions*, the SEC specifically criticized the company's alleged failure to adequately address an internal whistleblower complaint. According to the SEC's settled order instituting administrative proceedings, the company identified the legal and accounting issues raised by the complaint, but did not seek legal or accounting opinions about the propriety of the questioned practice, and thereafter closed its internal investigation based on "insufficient inquiry." According to the SEC's order, which the company agreed to without admitting or denying allegations, the company's audit committee further failed to inquire into the review of the complaint by the company's internal audit department.

In addition, the SEC for the second time sanctioned a company for using employee agreements viewed by the agency as impeding employees from voluntarily providing information to the SEC. In a March 2016 case against a large broker-dealer, the SEC alleged that the firm violated Exchange Act Rule 21F-17, which prohibits taking any action to impede someone from informing the SEC about a possible securities law violation. According to the SEC's settled order instituting proceedings, the firm's severance agreements included language prohibiting departing employees from disclosing confidential information absent a formal legal requirement or company authorization, which the SEC viewed as precluding employees from voluntarily reporting information to the government. The SEC further noted that, while the language was later revised to allow communications with the SEC, it limited such communications to the facts and circumstances surrounding the severance agreement itself.

Of course, the few dozen whistleblower awards to date pale in comparison to the thousands of complaints filed with the SEC's whistleblower office. Some of this is due to the lengthy time it takes for the SEC staff to investigate a matter and ultimately obtain a monetary recovery; moreover, some fruitful tips may result in recoveries below the $1 million threshold required to qualify for an award. Nonetheless, there can be little doubt that the SEC must wade through countless tips to find the meritorious ones. For example, an August 2014 SEC order describes an individual who claimed responsibility for an SEC enforcement action, backing up his or her purported whistleblower claims by sending the SEC "several public news stories about Israeli agents in Australia, a couple who pled guilty to money laundering in 2000, a merger between two banks, and the presidential pardon of Marc Rich." (The SEC denied the whistleblower claim.) And earlier that same year, the SEC issued an order denying any recovery to a whistleblower who submitted no fewer than 143 claims, claiming responsibility for nearly every SEC enforcement action filed from mid-2012 through 2013. (The SEC prohibited this individual from having any future whistleblower claims considered by the agency.)

It seems evident that the promise of a huge payoff will lure increasing numbers of self-proclaimed whistleblowers, not to mention their counsel, into the awaiting arms of the SEC. Even if many (or even most) of these claims lack merit (as suggested by some of the more colorful illustrations in the SEC's claim denials), companies confronted with whistleblower allegations have no choice but to treat them seriously. Failing to do so — or worse, taking steps viewed as discouraging whistleblowers from coming forward — can result in stand-alone enforcement proceedings by the SEC, or tougher sanctions if an underlying securities violation is found and charged by the agency.

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